Staff Findings
and Recommendations

Connecticut Insurance Fund Assessment Methodology

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Legislative Program Review
& Investigations Committee

CONNECTICUT GENERAL ASSEMBLY

Committee Staff on Project

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PRI Staff Report Highlights

December 2012

Assessment Methodology and Process to Fund the Connecticut Insurance Department

Background

In May 2012, the program review committee authorized a review of how the assessment to fund the Connecticut Insurance Department (CID) is carried out. In June, the committee approved a study scope that focuses on four areas:

- the way different categories of insurance companies are assessed to fund CID and its activities, as well as other state programs funded by insurance company assessments, and the amounts that result;
- the methodologies and mechanisms other states use to fund their insurance department activities, and the framework, basis, and process for any assessments or fees made in the various states;
- the trends in Connecticut in the number of insurers in the different assessment categories and the resulting amounts generated; and
- the scope and breadth of retaliatory tax laws and the implications of the treatment that Connecticut insurance companies might anticipate in other states if the methods of assessments were changed in Connecticut.

Key Terms:

Connecticut Insurance Fund: This is a dedicated fund that supports primarily the Insurance Department, but also the Office of Healthcare Advocate and a program aimed at preventing falls (generally among the elderly) within the Department of Social Services. The Insurance Fund is supported through an annual assessment on Connecticut-based insurers. Payments are made quarterly.

Retaliatory Tax: Forty-nine states have enacted laws imposing a retaliatory tax. The laws essentially declare that the same taxes, fees, licenses or other requirements imposed on State A's insurers by State B will be imposed on State B's insurers when transacting business in State A. (Also could be described, less harshly, as reciprocity.)

Main Staff Findings

The insurance industry is an important segment of Connecticut's economy. In FY 10, almost 61,000 jobs in the state were in the insurance industry, or about 5 percent of the total private sector jobs in Connecticut. Insurance carriers and related business contributed about $23.8 billion to the state's economy, or 10.7 percent of the state's gross state product. Thus, it is important that Connecticut provide a competitive environment for the insurers located here.

Regulation of the insurance industry is concentrated heavily in the state where companies are domiciled (i.e., home state, principal place of business). In FY 10, there were about 1,300 insurance nondomestic insurance companies licensed in Connecticut. Another **1`09 insurance companies were domiciled in the state.** Some of the companies domiciled in Connecticut are the largest companies nationally.

Connecticut is one of 30 states that have a dedicated insurance fund to support regulating the insurance industry, through an insurance department or division. Only two states, Connecticut and New York, assess only domestic insurers to fund their insurance departments.

There are myriad ways in which states assess insurance companies to fund their insurance departments. Common funding mechanisms are flat dollar assessments per license, or sometimes on per-person or other unit basis. Assessments based as a percent of premiums written are also common. **Connecticut appears to be the only state that bases its assessment on companies in the same ratio as their state premium tax liability.**

Linking the assessment to the premium tax liability makes it less transparent, and unnecessarily cumbersome, involving tax information to be provided from the Department of Revenue Services to CID.

Because the Insurance Fund assessment is made only on domestic insurers, it places a **heavy financial burden on insurers who write most of their premiums in Connecticut,** but who compete with much larger insurers (domestic and nondomestic) for business. Further, the assessment is not an accurate gauge of regulatory resources needed to oversee large insurers.

PRI Staff Recommendations

- ***The assessment for Insurance Fund shall continue to apply only to domestic insurers.***
- ***The assessment methodology should be changed to direct premiums written; however it should be applied to the premiums written nationwide. Each company's share of the Insurance Fund would be the same proportion as that insurer has of premiums written nationwide.***
- ***Health care centers (HMOs) as a group shall be required to pay 20 percent of the Insurance Fund assessment.***
- ***The overall cap on the portion of the total Insurance Fund assessment on any one insurer should be 15 percent rather than the current 25 percent.***
- ***CID should vigorously bill and collect reimbursements for work performed in regulating non-assessed companies, list the regulatory work performed in assessment materials, and indicate how the reimbursements have lowered the overall amount that needs to be collected from domestic companies.***

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Insurance Fund Assessment Methodology

Scope of Study

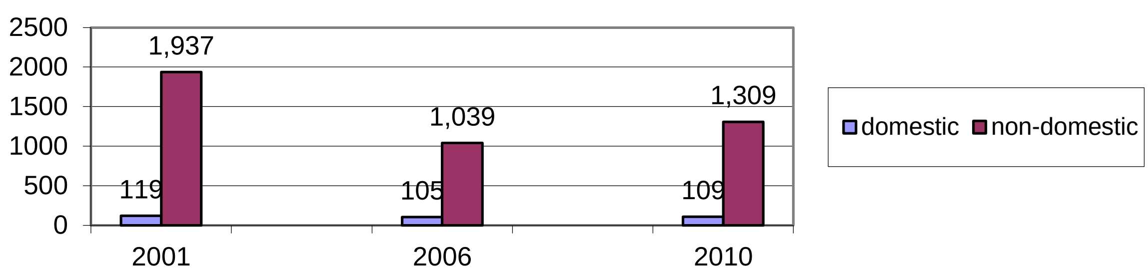
The committee undertook this study in late May 2012 after questions had been raised about the fairness of the way the Connecticut Insurance Department (CID) is funded, and equity of the assessment among companies doing business here. The committee approved the scope of study in late June, and incorporated several aspects including the way Connecticut funds the insurance department, the different categories of insurance companies and how they are assessed, and the basis and rationale for the assessments. The study focused on four areas:

- the way different categories of insurance companies are assessed to fund the CID and its activities, as well as other state programs funded by insurance company assessments, and the amounts that result;
- the methodologies and mechanisms other states use to fund their insurance department activities, and the framework, basis, and process for any assessments or fees made in the various states;
- the trends in Connecticut in the number of insurance companies in the different assessment categories and the resulting amounts generated by category; and
- the scope and breadth of retaliatory tax laws and the implications of the treatment that Connecticut insurance companies might anticipate in other states if the methods of assessments were changed in Connecticut.

Insurance Industry in Connecticut

As shown in Figure 1, there are about 1,400 insurers licensed to do business in Connecticut; 109 are domestic insurers, meaning Connecticut is their home state and principal place of business. Another 1,309 insurers are nondomestic companies.

Figure 1. Number of Domestic vs. Non-domestic Insurers in CT



Source: CID Annual Reports

In FY 10, there were 61,000 jobs in Connecticut related to the insurance industry, or about 5 percent of all the private sector jobs in the state. Insurance carriers and related businesses contributed about $23.8 billion to the state's economy that year, or about 10.7 percent of Connecticut's gross state product.

Insurance Fund

The insurance industry is primarily regulated by the states, rather than the federal government, and that oversight relies heavily on the regulatory entity in the state where companies are domiciled. Connecticut is one of 30 states that finance its insurance department through a dedicated insurance fund. Connecticut began its fund in 1980. Of the 30 states with a fund, 24 states, including Connecticut, completely support the fund with assessments on the regulated industry.

In FY 12, the Insurance Fund totaled $26.6 million, of which $24.3 million was to support the Connecticut Insurance Department (CID). The fund also finances all of the staffing and operating expenses of the Office of Healthcare Advocate, and a program in the Department of social services targeted at preventing falls among the elderly population.

The CID budget ranked 14th among all states, according to FY 10 comparative statistics compiled by the National Association of Insurance Commissioners (NAIC). However, when the insurance department budget is measured against direct written premiums in the state, another metric used by NAIC, Connecticut drops to 23rd.

There are a myriad of ways that states use to assess the industry to support their funds. Many states apply the assessment to direct written premiums in that state, while others assess on admitted assets, or flat dollar assessments per license or per-insured person basis. The vast majority of states that have an assessment specifically for funding the insurance department apply it to both domestic and nondomestic companies. Connecticut and New York are the only two states that apply the assessment only to domestic insurers.

In Connecticut, the assessment is made on domestic insurers in the same ratio as their premium tax liability. Therefore, each year the Connecticut Insurance Department must request the state Department of Revenue Services to furnish CID with the information. After that information has been provided by DRS, the insurance department can calculate what each insurer's assessment will be of the overall Insurance Fund expenses, based on the same ratio each insurer has of the overall premium tax liability. The billing for the assessment is made annually, but payments are due quarterly. CID deposits payments with the State Treasurer, which are then credited to the Insurance Fund.

There is currently a cap on the assessment made to any one insurer. No one company may be charged more than 25 percent of the Insurance Fund overall expenses; with the excess shared by all the other companies in the same proportion as the overall assessment.

Findings and Recommendations

PRI staff finds that the insurance industry is an important sector of the state's economy and there is an interest in ensuring the state cultivates a competitive environment for insurers located here.

PRI staff finds that the majority of states assess both domestic and nondomestic insurers. However, applying the assessment to nondomestic insurers would subject Connecticut insurers to that assessment in other states, through the retaliatory tax. This tax, which 49 states have implemented, essentially imposes the same taxes, fees, and licensing requirements on State A's insurers by State B as State B's insurers will incur when transacting business in State A. According to associations representing the insurance industry in Connecticut, applying the assessment to domestic insurers only is financially beneficial to most Connecticut insurers that write extensively in other states because of what is known as the retaliatory tax.

PRI staff agrees that, because of the national presence of large insurers domiciled here, if the assessment were applied to domestic insurers for CID fund assessment, other states would retaliate and Connecticut insurers would incur a greater financial risk than would benefit the state overall. This would be especially true in states like California, with an Insurance Fund many times the size of Connecticut's, and where Connecticut companies write substantial business. **Therefore, PRI staff recommends the Insurance Fund assessment continue to apply only to domestic insurers.**

However, at its September public hearing, the PRI committee heard testimony from representatives from one domestic company which believes it is bearing a disproportionate share of the assessment burden. Because this insurer writes most of its business in Connecticut, its assessment is based on that premium alone, yet must compete with insurers from other states with premiums written around the country. Those companies are not directly assessed for the CID's operating budget.

The PRI committee directed its staff at the hearing to try and develop an assessment methodology that would not put Connecticut domestic insurers at risk of paying the assessment in other states through the retaliatory tax, yet make the assessment methodology fairer for companies writing most of their premiums in Connecticut.

To that end, staff recommends that the methodology for the assessment for the insurance fund be based on the annual direct written premiums a Connecticut-domiciled company writes nationwide (as per schedule T in a company's annual report). Each individual domiciled insurer's assessment would be on the same proportion of payment to the fund as the proportion that insurer has of all premiums written nationwide.

The assessments would no longer be linked to the premium tax, and the proportion of each company's tax liability.

PRI staff believes this recommendation will make the base for the assessment much more transparent as the insurance department will no longer have to rely on receiving information from the state Department of Revenue Services on tax liability for state insurance companies before it can make the assessment. This seems to be unnecessarily burdensome, and does not promote transparency. Further, DRS is obviously vigilant about protecting taxpayer information, and thus concerned about confidentiality of information on individual companies and tax liability.

Further, as was indicated, based on PRI review of assessments in other states, Connecticut is the only state that links it to premium tax liability. Further, the amount of premiums written by a company is much more public, with each company required to file that information in its annual report to the insurance commissioner in the state where the insurer is domiciled. Thus, that information would be readily available to CID. In fact, the insurance department proposed legislation moving to a state premium-based assessment in 2011, and while reported favorably out of committee, was not brought up for action by either chamber.

Applying the assessments to all the premiums a company writes nationwide will be a better reflection on the regulatory resources needed to oversee the very large Connecticut companies actively writing in other states. Further, because Connecticut applies the assessment only to domestic companies, it means that Connecticut companies are not being charged for other state's fund through a retaliatory tax.

The staff considered the option of making adjustments to the tax credits, which currently allow a tax credit of 80 percent of the insurance fund assessment for smaller companies. However, given that tax credit use is confidential, it is difficult to know how credit adjustments could be made, and to which companies the credits would apply to make the assessments more equitable. Finally, PRI staff concludes that in creating the Connecticut Insurance Fund in 1980, policymakers believed that insurance companies should pay for the regulation of the industry. Making adjustments to the credits, rather than adjusting the assessment base as recommended, would shift more of the assessment to taxpayers.

Share by insurance type. Health maintenance organizations (HMOs) are licensed differently than other types of insurers. Since these HMOs, also known as health care centers, establish networks with providers in that state and do not just pay claims etc., each state in which these entities do business is considered the home state of incorporation. As such, only the book of business written in the home state is considered, and the HMO is not competing with other HMOs from outside Connecticut for business. However, that does not diminish the regulatory resources required to oversee the area. In fact one could argue that because the networks and access issues must also be examined, the scope of regulation is more intensive.

Historically, medical service corporations and hospital service corporations, which appear to be the predecessors of HMOs, were licensed by the Insurance Department and were collectively required by statute to pay 20 percent of the assessment (C.G.S. Sec. 38a-48 (c) (1)). However, CID indicates this type of entity no longer exists, so currently the entire assessment is borne by all domestic insurers, including HMOs.

While applying the assessment based on proportion of nationwide premiums will go a long way to making the assessment fairer to domestic companies based on national size, there are some additional assessment adjustments that PRI staff proposes.

Staff recommends that health care centers (health maintenance organizations) together be required to pay 20 percent of the expenses the assessment funds.

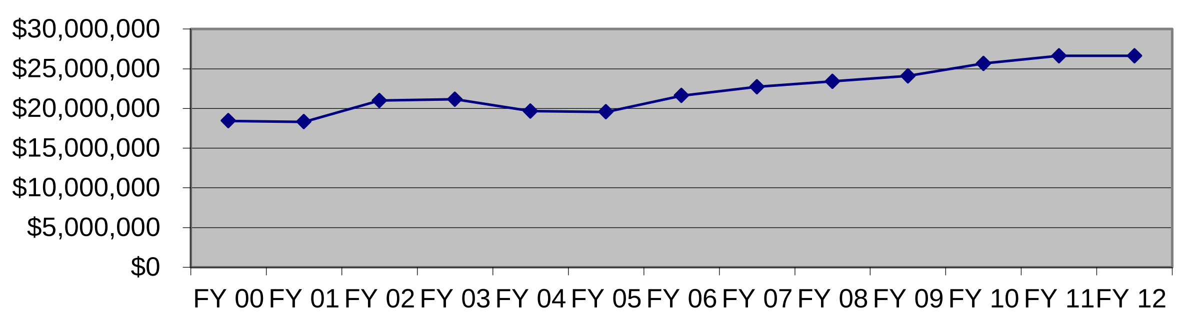
PRI believes there is a need to ensure that the health maintenance organizations are responsible for a base percent of the insurance department expenses, the 20 percent currently outlined in statute. If there is not an adjustment made for that, HMOs will enjoy an unearned windfall. That would occur because HMOs do not write business in other states, and the proposed changes to the assessment methodology would dilute their ratio of Insurance Fund expenses relative to other companies with significant premiums written in other states.

Overall cap. Currently there is a statutory cap on the assessment, mandating that no one company be charged more than 25 percent of the expenses, with the excess over that amount shared by all other companies in the same ratio as the overall assessment. PRI staff believes there should be a cap on the percent of the expenses paid by any one company, but the cap should be a lower percentage than the current 25 percent.

Therefore, PRI staff recommends that no one company should be charged more than 15 percent of the expenses of the Insurance Fund, and that the excess above that be shared by all the other companies in the same ratio as the overall assessment.

PRI staff concludes that when the Insurance Fund was first created in 1980, CID budget amounts were significantly lower than they are currently. In addition, responsibility for other expenses like support of the Office of Healthcare Advocate, have been added to the fund. As Figure 2 shows, the Insurance Fund has grown considerably over the years, increasing about 45 percent from FY 00 through FY 12.

Figure 2. Insurance Fund Appropriations -- FY 00-FY 12



Source: OFA Budgets

At the current 25 percent cap, and the approximate $27 million for FY 13 Insurance Fund, that would translate to a cap of $6.75 million dollars, a significant amount for a single company to pay, even if the assessment payments are due quarterly and not in on lump sum. PRI staff believes that the proposed change in the assessment base to nationwide premiums will more accurately reflect the size of the company overall. However, at the same time it is also prudent to adjust the cap threshold so that no one insurer bears the burden of a huge assessment, regardless of the company's size. At 15 percent cap of the $27 million fund total would mean that no one company would have to pay more than $4.1 million, a more reasonable amount, especially when paid in quarterly increments.

Reimbursements and assessment reduction. Connecticut statutes require that the actual costs and expenses of the regulatory examinations and reviews conducted of certain companies be billed to the companies and reimbursed to the department. The companies include nondomestic companies, and domestic companies who are not billed for the Insurance Fund assessments, including reinsurers, and fraternal benefit societies (Sec.38a-14h). The reimbursements are for actual work performed including market conduct reviews (C.G.S Sec. 38a-15) examinations (Sec. 38a-49) and valuations of reserves (Sec. 38a-50). For the latter two examinations, the statute specifically lays out how the calculation of staffing and other costs to be reimbursed.

It is not clear to PRI staff that CID is not collecting for the costs of all such reviews and examinations being conducted. PRI obtained from CID billings FY 12. The list showed seven nondomestic companies billed for market conduct reviews for a total of $290,552 and four companies, not subject to the Insurance Fund assessment, billed for financial examinations for $569,685.

However, PRI staff reviewed the list completed market conduct reviews on the CID website, and found that there were an additional 63 market conduct reviews of nondomestic insurers completed during FY 12. It was not clear from looking at the reports the actual time CID examiners spent completing the reviews, and CID staff indicated that some of them require minimal time. However, even if the reviews took one reviewer one week -- at $80,000 mid-range salary -- that translates to $1,500 per review (without fringe). The listing of completed financial and reserves examinations is not up-to-date on the CID website, so PRI could not analyze the results of the billed amounts compared to all work done.

The reimbursed amounts from the nondomestic companies and otherwise non-assessed companies are required to be deposited to the Insurance Fund and accounted for as expenses recovered from insurance companies, and reduce the expenses of the Insurance Fund assessments are levied on domestic insurers. However, PRI staff finds it is not clear to what extent this is being done.

To address these concerns, PRI staff recommends:

- **The CID vigorously bill and collect reimbursements for actual work performed on non-assessed companies.**

- **The CID include a listing of all individual reviews and evaluations done involving non-assessed companies in the materials it distributes to domestic companies when it levies the assessment.**

- **Further, the assessment information should clearly show how those reimbursement amounts have been applied to the Insurance Fund, and hence the reduction in the overall amount that needs to be levied on assessed domestic companies.**

With this additional transparency, it should provide a greater level of assurance to domestic companies that the non-assessed companies are being charged for actual examinations and reviews done on those particular companies. Furthermore, it would make more public that the reimbursements are being accounted for and how the collections reduce the overall assessment amount.